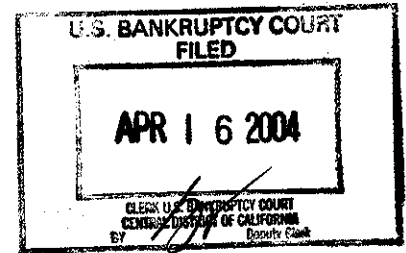
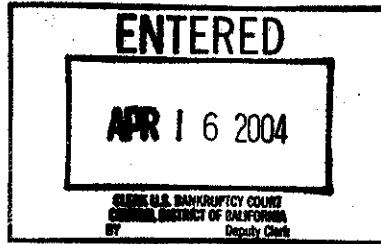


**FOR PUBLICATION**



UNITED STATES BANKRUPTCY COURT  
CENTRAL DISTRICT OF CALIFORNIA

In re ) Case No. SA 00-19215 JR  
FLASHCOM, INC., ) Adv. No. SA 02-1620 JR  
Debtor. ) Chapter 11

CAROLYN A. DYE, Liquidating  
Trustee,

Plaintiff,  
vs.

ANDRA SACHS; COMMUNICATIONS  
VENTURES III, LP; COMMUNICATIONS  
VENTURES III CEO & ENTREPRENEURS'  
FUNDS LP; MAYFIELD IX; MAYFIELD  
ASSOCIATES FUNDS IV; DAVID HELFICH;  
TODD BROOKS; BRADFORD SACHS;  
RICHARD RASMUS; and KEVIN FONG,

Defendants.

MEMORANDUM OPINION

Date: April 8, 2004  
Time: 9:30 A.M.  
Courtroom: 5A

I. INTRODUCTION

After filing a chapter 11<sup>1</sup> petition, Flashcom, Inc.  
("Debtor") filed a plan of reorganization that was confirmed on

<sup>1</sup> Unless otherwise indicated, all chapter, section, and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330 and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036.

Scanned  
By: SP

SP

1 December 11, 2001. Debtor's plan made Carolyn Dye ("Trustee")  
2 liquidating trustee for Debtor's estate.

3 On July 11, 2002, Trustee filed a complaint (the "Complaint")  
4 against the defendants listed above ("Defendants"). Defendants  
5 filed a motion for partial summary judgment (the "Motion"),  
6 asserting that the California Corporations Code ("CCC") does not  
7 apply to the claims asserted in the Complaint as a matter of law.  
8 Trustee opposed the Motion. After the hearing on April 8, 2004, I  
9 took the matter under submission.

## 10 11 **II. JURISDICTION**

12 I have jurisdiction over this matter under 28 U.S.C.  
13 § 157(b)(1). This is a core proceeding under the Bankruptcy Code,  
14 as defined in 28 U.S.C. § 157(b)(2)(A), (F), (H) and (O).

## 15 16 **III. STATEMENT OF FACTS**

17 The Complaint alleges the following: Defendants either  
18 orchestrated or participated in certain unauthorized, improper, or  
19 otherwise avoidable agreements and transfers (the "Agreements and  
20 Transfers") with Debtor between September 1999 and February 2000.  
21 Most significantly, Debtor improperly redeemed stock held by Andra  
22 Sachs for \$9 million (the "Stock Redemption") on February 23,  
23 2000.

24 Also, David Helfrich, Todd Brooks, Bradford Sachs, Andra  
25 Sachs, Richard Rasmus, and Kevin Fong were members of Debtor's  
26 board of directors. Communications Ventures III, LP and  
27 Communications Ventures III CEO & Entrepreneurs Fund LP (the "CV  
28 Defendants") were shareholders of Debtor and were controlled by

1 Helfrich. Mayfield IX and Mayfield Associates Funds (the  
2 "Mayfield Defendants") were shareholders of Debtor and were  
3 controlled by Brooks and Fong.

4 The Complaint includes claims for (1) avoidance and recovery  
5 of unauthorized corporate agreements and payments under CCC § 310,  
6 Delaware law, and other applicable non-bankruptcy law (the "Fifth  
7 Claim"); (2) avoidance and recovery of improper corporate  
8 agreements and payments under CCC §§ 501-503, 506, and 2115 (the  
9 "Seventh Claim"); (3) breach of fiduciary duty by Debtor's  
10 directors and officers under CCC §§ 315-317 and 2115-2116, and  
11 Delaware law (the "Tenth Claim"); (4) negligence and corporate  
12 waste under CCC §§ 315-317 and 2115-2116, and Delaware law (the  
13 "Eleventh Claim"); and (5) liability for unlawful dividends,  
14 purchase, or redemption under CCC §§ 316 and 2115-2116, and  
15 Delaware law (the "Twelfth Claim").

16 The CV Defendants, the Mayfield Defendants, Helfrich, Brooks  
17 and Fong ("Movants") seek partial summary judgment, arguing that  
18 the CCC did not apply to Debtor at the time the Agreements and  
19 Transfers occurred. Movants argue that CCC § 2115, which makes  
20 certain provisions of California law<sup>2</sup> applicable to foreign  
21 corporations if certain requirements<sup>3</sup> are met over a specified  
22

---

23 <sup>2</sup> The CCC sections listed under CCC § 2115(b) include: § 316  
24 (liability of directors for unlawful distributions), § 317  
25 (indemnification of directors, officers, and others), §§ 500 to 505  
26 inclusive (limitations on corporate distributions in cash or  
property), and § 506 (liability of shareholder who receives  
unlawful distribution). See Cal. Corp. Code § 2115(b).

27 <sup>3</sup> In general terms, the requirements measure the extent of a  
28 foreign corporation's activity in California. This "three-factor  
formula" includes a property factor, a payroll factor, and a sales  
factor, as those terms are defined in the California Revenue and  
Taxation Code. See Cal. Corp. Code § 2115(a).

1 period of time,<sup>4</sup> was not triggered by Debtor until January 1,  
2 2001, after the Agreements and Transfer took place. Accordingly,  
3 Movants contend that they are entitled to partial judgment on  
4 those claims in the Complaint that are based on CCC  
5 § 2115.

6 Additionally, Movants assert that as a Delaware corporation,  
7 the doctrine of internal affairs requires the application of  
8 Delaware law to issues of Debtor's internal affairs, including the  
9 Agreements and Transfers. Therefore, Movants argue that CCC  
10 §§ 310 and 315 do not apply to Debtor and that summary judgment on  
11 those claims is appropriate. Andra Sachs joins the Motion.

12 In opposition, Trustee argues that the trigger date for the  
13 application of CCC § 2115 to Debtor was January 1, 2000, prior to  
14 the Stock Redemption. Trustee also asserts that the internal  
15 affairs doctrine does not apply under these circumstances given  
16 Debtor's extensive activities in California. Accordingly, Trustee  
17 argues that her claims based on California law should stand.

18 The following facts are undisputed:

- 19 1) Debtor was first incorporated in Nevada on May 19, 1998;
- 20 2) Debtor was reincorporated in Delaware on January 20, 1999;
- 21 3) Debtor was operating as a foreign corporation in
- 22 California at all relevant times;
- 23 4) Debtor's fiscal year is set as the calendar year; and
- 24 5) Just for the Motion, Debtor's activity in California
- 25 satisfied the three-factor formula under 2115(a) at all
- 26

---

27 <sup>4</sup> Under CCC § 2115(a), the three-factor formula must be met  
28 for a "full income year." Subdivision (d) then provides a trigger  
date for the application of the CCC sections specified in  
subdivision (b). See Cal. Corp. Code § 2115(a).

relevant times.

#### IV. DISCUSSION

##### 1. The Application of CCC § 2115

CCC § 2115 provides in relevant part:

(a) A foreign corporation . . . is subject to the requirements of subdivision (b) commencing on the date specified in subdivision (d) and continuing until the date specified in subdivision (e) if:

(1) the average of the property factor, the payroll factor, and the sales factor (as defined in Sections 25129, 25132, and 25134 of the Revenue and Taxation Code) with respect to it is more than 50 percent during its **latest full income year** and

(2) more than one-half of its outstanding voting securities are held of record by persons having addresses in this state appearing on the books of the corporation on the record date for the latest meeting of shareholders held during its latest full income year or, if no meeting was held during that year, on the last day of the latest full income year. The property factor, payroll factor, and sales factor shall be those used in computing the portion of its income allocable to this state in its franchise tax return or, with respect to corporations the allocation of whose income is governed by special formulas or that are not required to file separate or any tax returns, which would have been so used if they were governed by this three-factor formula.

. . . .

(d) For purposes of subdivision (a), the requirements of subdivision (b) shall become applicable to a foreign corporation only upon the first day of the first income year of the corporation (1) commencing on or after the 135th day of the income year immediately following the latest income year with respect to which the tests referred to in subdivision (a) have been met or (2) commencing on or after the entry of a final order by a court of competent jurisdiction declaring that those tests have been met.

1 Cal. Corp. Code § 2115 (emphasis added). Here, the only issue  
2 pertaining to the application of CCC § 2115 is when the trigger  
3 date under subsection (d) occurred. The statute is clear that the  
4 three-factor formula under subdivision (a) must be met for a "full  
5 income year" before the trigger date can be determined under  
6 subdivision (d).

7       Movants argue that the term "full income year" means a full  
8 calendar or fiscal year. Under this interpretation, Debtor  
9 satisfied subdivision (a) in 1999,<sup>5</sup> causing the 135-day count to  
10 begin on January 1, 2000, thereby making January 1, 2001 the  
11 trigger date under subdivision (d).

12       Trustee argues that the term "income year" under subdivision  
13 (d) does not require a full fiscal or calendar year. Rather,  
14 Trustee asserts that the income year requirement is met by the  
15 period from May 19, 1998 to December 31, 1998, or by the period  
16 from May 19, 1998 to May 19, 1999. In either case, the trigger  
17 date under subdivision (d) would then be January 1, 2000, prior to  
18 the Stock Redemption on February 23, 2000.

19       No reported cases discuss the meaning of "full income year"  
20 as used in CCC § 2115. However, the three-factor formula under  
21 subdivision (a) is based on data "used in computing the portion of  
22 [the foreign corporation's] income allocable to this state in its  
23 franchise tax return . . . ." Cal. Corp. Code 2115(a)(2).  
24 Section 2115(a)(1) also states that the three factors are defined  
25

---

26  
27       <sup>5</sup> Although Debtor began its operations in May 1998, Debtor's  
28 fiscal year was set as the calendar year, making the period from  
May to December 1998 less than a full calendar or fiscal year.  
Therefore, Debtor's first full fiscal year was 1999.

1 in the California Revenue and Taxation Code. For the purposes of  
2 calculating franchise taxes, the term "income year" is defined as  
3 "the calendar year or the fiscal year upon the basis of which the  
4 net income is computed." Cal. Rev. & Tax. Code § 23042.

5 Indeed, the only workable definition of "full income year" as  
6 used in CCC § 2115 is a full calendar or fiscal year.<sup>6</sup> A foreign  
7 corporation must apply the three-factor formula to its activities  
8 in California using data from its franchise tax return. Franchise  
9 taxes are payable for every "taxable year," which is also defined  
10 as a calendar year or fiscal year. Id. § 23041. Therefore, a  
11 foreign corporation cannot determine whether its activity in  
12 California satisfies the three-factor formula for a full income  
13 year without data from a full fiscal or calendar year.

14 The California Court of Appeal has explained:

15  
16 In construing statutory language, our  
17 fundamental task is to ascertain the intent of  
18 the lawmakers so as to effectuate the purpose  
19 of the statute. We begin by examining the  
20 statutory language, giving the words their  
usual and ordinary meaning. If there is no  
ambiguity, then we presume the lawmakers meant  
what they said, and the plain meaning of the  
language governs.

21 People v. Connor, 115 Cal. App. 4th 669, 678 (2004); see also  
22 Great Lakes Props., Inc. v. City of El Segundo, 19 Cal. 3d 152,  
23 155 (1977) (stating that unless a term is specifically defined by  
24

---

25  
26 <sup>6</sup> The limited secondary authority interpreting CCC § 2115 has  
27 also found that the term "income year" refers to the calendar year  
28 or fiscal year upon which a foreign corporation computes its net  
income and franchise taxes. See 2 Marsh, Marsh's California  
Corporation Law, § 26.04[c], 26-86 (4th ed. 2000); see also  
Ballantine & Sterling, California Corporaton Laws, § 393.04 (2003).

1 statute, or it is clearly shown that a different meaning was  
2 intended, the plain meaning governs). Here, "calendar year" is  
3 not defined under the CCC or the California Revenue and Taxation  
4 Code. However, "[t]he literal meaning of the term 'calendar year'  
5 is the period of twelve months between January 1 and December 31."  
6 Jensen v. Johnson County Youth Baseball League, 838 F. Supp. 1437,  
7 1441 (D. Kan. 1993) (citing Bonray Oil Co. v. Dep't of Energy, 472  
8 F. Supp. 899, 902 (D. Okla. 1978)). Accordingly, the term "full  
9 income year" as used in CCC § 2115 means a full fiscal year or  
10 twelve-month period from January 1 to December 31.

11 Here, Debtor's fiscal year was set as the calendar year.  
12 Therefore, Debtor's first full fiscal year, or first "full income  
13 year," was 1999. For purposes of the Motion, the parties agree  
14 that Debtor's activity in California in 1999 satisfied the three-  
15 factor formula. Under subdivision (d), the 135-day period began  
16 to run on January 1, 2000 and expired on May 13, 2000, making  
17 January 1, 2001 "the first day of the first income year . . .  
18 commencing on or after the 135th day . . . ." Therefore, January  
19 1, 2001 was the trigger date for the application of CCC § 2115 to  
20 Debtor.

21 The Agreements and Transfers took place no later than  
22 February 2000. Therefore, Debtor was not subject to the  
23 provisions of the CCC listed under CCC § 2115(b) at the time the  
24 Agreements and Transfers occurred. Accordingly, Movants are  
25 entitled to judgment on the Seventh, Tenth, Eleventh, and Twelfth  
26 Claims, to the extent brought under CCC § 2115.  
27  
28



2. The Internal Affairs Doctrine

A California court describes the internal affairs doctrine as:

[A] conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs-matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders-because otherwise a corporation could be faced with conflicting demands. States normally look to the State of a business' incorporation for the law that provides the relevant corporate governance general standard of care.

State Farm Mut. Auto. Ins. Co. v. Superior Court, 114 Cal. App. 4th 434, 442 (2003) (quoting Edgar v. MITE Corp., 457 U.S. 624, 645 (1982) and Atherton v. FDIC, 519 U.S. 213, 224 (1997)). "In general, courts in California follow this rule and apply the law of the state of incorporation in considering claims relating to internal corporate affairs." In re Sagent Tech., Inc., 278 F. Supp 2d 1079, 1087 (N.D. Cal. 2003). Indeed, the internal affairs doctrine, as applied to director liability, has been codified in California. See Cal. Corp. Code § 2116.

This does not mean that California has no role in governing the conduct of foreign corporations. Clearly, California law applies to conduct unrelated to the internal affairs of a foreign corporation. See Valtz v. Penta Inv. Corp., 139 Cal. App. 3d 803, 807 (1983) (applying California law to a shareholder's demand to inspect a foreign corporation's records and noting that such activity is not an internal corporate affair); Western Air Lines, Inc. v. Sobieski, 191 Cal. App. 2d 399, 409-10 (1961) (holding

1 that a foreign corporation must comply with California securities  
2 laws when entering into stock transactions with California  
3 residents and noting that such activity is not an internal  
4 affair). Additionally, California law may apply to the internal  
5 affairs of a foreign corporation under a specific statute. See  
6 Havlicek v. Coast-to-Coast Analytical Servs., Inc., 39 Cal. App.  
7 4th 1844 (1995) (applying California law to a director's right to  
8 inspect a foreign corporation's records under CCC § 1602); Wilson  
9 v. Louisiana-Pacific Res., Inc., 138 Cal. App. 3d 216 (1982)  
10 (rejecting a constitutional challenge to CCC § 2115 as applied to  
11 a foreign corporation).  
12

13 Here, Debtor is a foreign corporation incorporated in  
14 Delaware. Trustee does not dispute that the Agreements and  
15 Transfers involve the internal affairs of Debtor. Additionally,  
16 as discussed above, the trigger date under CCC § 2115(d) occurred  
17 after the Agreements and Transfers took place. Finally, Trustee  
18 has not identified any other specific statute in the Complaint  
19 applying the CCC to the conduct of a foreign corporation.

20 Therefore, Delaware law governs the Agreements and Transfers, and  
21 Movants are entitled to judgment on the Fifth, Seventh, Tenth,  
22 Eleventh, and Twelfth Claim, to the extent brought under the CCC.  
23

## 24 25 V. CONCLUSION

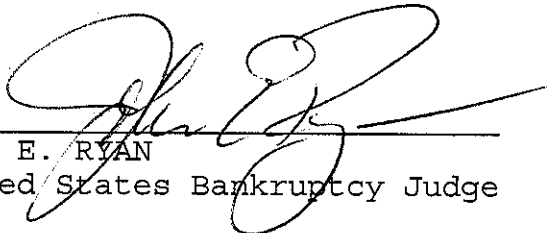
26 The plain language and practical application of CCC § 2115  
27 show that the term "full income year" as used in subdivision (a)  
28 means a full fiscal year or twelve-month period from January 1 to

1 December 31. Debtor's first full fiscal year was 1999, making  
2 January 1, 2001 the trigger date under subdivision (d).

3 With several statutory exceptions, including CCC § 2115, the  
4 law of the state of incorporation governs the internal affairs of  
5 a corporation. Here, Debtor was incorporated in Delaware and  
6 operated as a foreign corporation in California. Additionally,  
7 CCC § 2115 and the provisions listed therein did not apply to  
8 Debtor until after the Agreements and Transfers took place.  
9 Therefore, Delaware law governs the internal affairs of Debtor  
10 during the relevant period, and partial summary judgment on the  
11 Fifth, Seventh, Tenth, Eleventh, and Twelfth Claims, to the extent  
12 brought under the CCC, is appropriate.  
13

14 This memorandum opinion shall constitute my findings of fact  
15 and conclusions of law.

16 Dated: April 16, 2004  
17

18   
19 JOHN E. RYAN  
20 United States Bankruptcy Judge  
21  
22  
23  
24  
25  
26  
27  
28

UNITED STATES BANKRUPTCY COURT  
CENTRAL DISTRICT OF CALIFORNIA

In re	)	Case No. SA 00-19215 JR
FLASHCOM, INC.,	)	Adv. No. SA 02-1620 JR
	)	Chapter 11
Debtor.	)	NOTICE OF ENTRY OF ORDER

TO:

DAVID R. WEINSTEIN  
WEINSTEIN, EISEN & WEISS LLP  
1925 CENTURY PARK EAST, SUITE 1150  
LOS ANGELES, CA 90067

ROBERT G. WILSON  
COTKIN, COLLINS & GINSBURG  
300 SOUTH GRAND AVENUE, 24<sup>TH</sup> FLOOR  
LOS ANGELES, CA 90071

HEATHER L. MAYER  
LATHAM & WATKINS  
633 WEST FIFTH STREET, SUITE 4000  
LOS ANGELES, CA 90071

ROBERT FRANKLIN  
MURRAY & MURRAY  
19300 STEVENS CREEK BOULEVARD  
CUPERTINO, CA 95014

Arthur Marquis  
Office of the United States Trustee  
411 West Fourth Street, Suite 9041  
Santa Ana, CA 92701-8000

You are hereby notified, pursuant to Bankruptcy Rule 7055  
and 9022, that a judgment or order entitled **Memorandum Opinion  
and Order** was entered on

**APR 16 2004**


I hereby certify that I mailed a copy of this notice to the  
above-named persons on

**APR 16 2004**

Dated: **APR 16 2004**

JON D. CERRETO

By

  
Deputy Clerk